

CIA/OER/S-07132-74 SOUTH VIETNAM'S OIL PROSPECTS
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MEMORANDUM

South Vietnam's Oil Prospects

Discoveries of oil in the first two wells drilled on South Vietnam's continental shelf have stimulated considerable conjecture concerning the potential foreign exchange benefits to Saigon.

All that is certain thus far is that neither strike has yet proven commercially exploitable, although the second (in October) apparently is more promising than the first (in August).

Although detailed assessment of oil revenue prospects is impossible at this time, the following paragraphs on oil production, related income flows, and licensing arrangements provide enough perspective on orders of magnitude to make it clear the contribution of oil to South Vietnam's economic capabilities is limited over the foreseeable future.

Production Outlook

The scant information available thus far supports a wide range of production possibilities but specifies none. Sustained production of 30,000 barrels per day from one drilling platform is generally considered the minimum to be commercially feasible under the deeper waters of the South China Sea and would yield some \$70-\$80 million in net annual

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revenues for the South Vietnamese government.* The two test wells drilled do not provide enough data for us to judge if this minimum level is attainable from the field being explored by Pecten Vietnam, a Shell subsidiary operating with Cities Service. If this level should prove to be attainable, there is as yet no ground for hopes that it will be significantly exceeded.

Operation of a producing platform is unlikely much before 1978. First, the current test-drilling schedule is unhurried. Pecten has recently begun drilling at a third of five test sites in its concession areas and estimates that six months or more will still be required before the commercial exploitability of its concessions can be ascertained. Other companies are either just beginning or have yet to drill. Second, the generally accepted lag from discovery to first sale is on the order of three years given current backlogs for leasing oil-producing equipment.

Even if South Vietnam's offshore oil finds are found to be commercially exploitable -- and prospects are steadily improving -- the resulting annual foreign exchange savings/earnings** probably will only amount to something on the order of \$100 million by 1980. Because production -- if started at all -- would still only be in its early stages in 1977 or 1978, any foreign exchange benefits in those years would be far smaller. If all goes well, oil production in the 1980s could exceed projected domestic petroleum needs of some \$150 million, thus enabling South Vietnam to become a net oil-exporting nation. However, there are no grounds yet for speculating that South Vietnam's annual oil production earnings will be much more than that.

*With production at 30,000 barrels per day and assuming current prices (\$12.60 a barrel), gross revenues would be about \$130 million annually. However, after deducting probable costs and oil company profits, the net accruing to the Saigon government would be about 65% of gross.

**Foreign exchange benefits come not only from sales of crude exports but also from substitution of petroleum products based on Vietnamese crude for current imports.

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Concession Contract Income

Over the next few years, South Vietnam will be earning some foreign exchange from the nascent oil sector even if no commercial production occurs. In addition to charging certain forms of rent for allowing exploration, it will benefit from various traditional stipends provided by oil companies to ease their entry into the country.

The GVN has awarded 13 tracts from their offshore holdings to the international oil companies in two rounds of biddings. As a result of the first round in July 1973, winning companies paid \$17 million in one-time signature bonuses and are paying \$240,000 annually in rental fees for the 8 tracts awarded until the leases come up for renewal in 1978. The second round of bidding, which resulted in the awarding of 5 more tracts in May 1974, yielded South Vietnam an additional \$30 million in one-time signature bonuses and rental fees estimated at \$145,000 annually for five years. The contracts for both sets of concessions call for further one-time, lump-sum bonus payments on the order of \$10 million per concession if exploitable oil is found in sufficient quantities.

Some more income can be expected from remaining exploration tracts, but it is likely to be modest. After the second round of bidding, there were still 28 tracts to let because bids either were not made, were unacceptable, or were turned down by the oil companies. In addition, the government still holds 19 tracts in reserve for later use. The most important factor that will limit future bidding is that 21 of the 47 unawarded tracts are in areas of conflicting boundary claims with Indonesia, Cambodia, Malaysia, and Thailand. Bidding companies have generally stayed clear of these areas, and the disputed claims are unlikely to be settled in the near future. The returns from the remaining 26 undisputed tracts will be limited somewhat by the likelihood that they are poorer seismic risks than those already being explored and by the desire of South Vietnam's government to preserve the best of what remains for its own use. Consequently, additional biddings during the remainder of the decade probably will yield only some \$75 million in one-time signature bonuses and rental fees of some \$750,000 annually.

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Because we are just beginning to have some sense of commercial oil possibilities for South Vietnam, there remains the question of what major new discoveries could mean for exchange receipts and growth in coming years. As in any case of setting limits to the unknowable, this issue leaves one with the unsatisfied sense that whole estimates could be turned around overnight. A careful reading of the above materials tends to dispel this notion in the Vietnamese case, however. Lead times for development and longstanding, complex security problems make it fairly plain that the oil development pace in South Vietnam will be modest under any plausible circumstances through the rest of the 1970s.

A considerable amount of test drilling is scheduled to take place over the course of the next year. Its intensity is, however, constrained by equipment shortages. Already Esso has had to delay drilling its first test well from early 1975 to sometime in June or July because of the limited availability of drilling rigs. Moreover, the relatively short-term charters on rigs are such that drilling programs will be frequently interrupted as equipment is jockeyed between concessions in South Vietnam and elsewhere.

The intensity of test-well drilling has only limited bearing on the production levels likely to be reached by the end of the decade. Even if tests confirm exploitable wells, this merely hastens the ordering process for already scarce production equipment. Regardless of the favorableness of test wells, it still takes at least two-and-a-half years to deliver a production platform once it is ordered. In fact, the crude production may even be slowed by competition for platforms, ancillary equipment, and manpower. Even the logistics of oil development in South Vietnam, where favorable seismic conditions are 100-200 miles offshore, suggest that this will be one of the relatively high-cost production areas for some time and could be among the first to experience cutbacks if oil prices broke suddenly. Given current estimates on the relative profitability of South Vietnam's oil fields, companies are unlikely to divert equipment from more favorable drilling activities in Malaysia and Thailand.

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The oil companies that were awarded offshore concessions have promised to pay South Vietnam an additional \$2.1-\$3.4 million annually through 1977 in the form of fringe benefits. Of this, \$700,000 a year will be given in grant aid for the training of South Vietnamese workers in oil industry-related jobs. Oil company purchases of Vietnamese goods and services, such as construction materials and food, are to make up the remaining \$1.4-\$2.7 million. These payments, already committed by the oil companies, probably will be increased by another \$1-\$2 million, and extended at least through the end of the decade as additional oil concession activities are undertaken over the coming years.

Related Capital Flows

If favorable prospects for sizable oil production are confirmed, flows of foreign private investment on the order of \$25-\$50 million or more could be attracted to South Vietnam. Most of this investment would occur in various oil-related industrial sectors. Of particular importance would be the development of a capacity for manufacturing fertilizer, pesticides, and herbicides in support of the country's large agricultural sector. South Vietnam spends over \$100 million annually on imports of these commodities. Undoubtedly, another target industry for foreign investment funds would be the refining of petroleum products. Finally, foreign investors might wish to establish a rudimentary petrochemical complex for the manufacture of various basic materials.

Also, a booming oil business would enhance both the overall investment climate in South Vietnam and the ability of the government to borrow substantial amounts of funds on international capital markets. The South Vietnamese government, previously unwilling to incur an international debt burden because of its small foreign exchange earning base, could easily establish itself as a safe credit risk when underwritten by favorable oil prospects. These additional foreign funds, indirectly related to South Vietnam's oil development, could amount to another \$25 to \$50 million at the end of the decade.

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Ironically, major new discoveries could prove a medium-turn liability. They would, of course, create the sort of reserve base that permitted substantial export growth and thereby reduced dependence on aid, but most of the exploitation of the new resource would likely occur after 1980. Then, the annual gains might move up fairly rapidly to \$200 million or more. Expectations of how this gain might serve Vietnam would, unfortunately, be piqued immediately with the announcements of discoveries. A likely consequence would be premature foreign pressure to reduce aid and a tendency toward laxness on the part of the Vietnamese in pursuing austerity measures sorely needed to continue the increase in domestic saving. In short, there is a high order of risk that inflated notions of oil earnings would do more to upset than spur Vietnamese development through the rest of the 1970s.

Conclusion

Although the prospects for some oil production by the end of the decade have improved as a result of the recent discoveries, they still provide scant basis for projecting major revenues from this source during the remainder of the 1970s. Considering security problems, normal engineering lead times, and some of the administrative difficulties experienced so far, there is a strong possibility that crude oil will not be produced in appreciable quantities before 1980.

If subsequent discoveries justify more widespread activity and development does pick up momentum, the gains could compare very favorably to South Vietnam's present sources of export income. By 1980, foreign exchange savings/receipts from oil could go as high as \$100 million, based on the single drilling platform that might be on stream at that point. Concession rent, various fringe benefits, and investment in on-shore facilities and related industries would provide perhaps another \$100 million. While this would considerably narrow South Vietnam's foreign exchange gap, it could not be taken as a panacea for the country's serious economic problems.

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